IN THE UNITED STATES DISTRICT COURT

FOR THE EASTERN DISTRICT OF CALIFORNIA

NATIONAL CITY BANK OF INDIANA, and NATIONAL CITY MORTGAGE CO., Plaintiffs, v. DEMETRIOS A. BOUTRIS, in his official capacity as Commissioner of the California Department of Corporations, Defendant.	CIV. NO. S-03-0655 GEB JFM ORDER

Plaintiffs National City Bank of Indiana ("National City Bank") and National City Mortgage Co. ("NCMC") move for a preliminary injunction that would enjoin Defendant Demetrios Boutris, in his official capacity as the Commissioner of the California Department of Corporations ("the Commissioner") and his agents from enforcing or taking any action to enforce the California Residential Mortgage Lending Act ("CRMLA"), California Financial Code § 50002 *et seq.* (including § 50204(o)), and California Civil Code § 2948.5 against Plaintiffs; from taking any action to prevent or interfere with Plaintiffs' business operations in California (including taking any action to impose penalties on Plaintiffs); and from otherwise

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exercising visitorial powers over Plaintiffs. Plaintiffs argue they are subject to exclusive federal Office of the Comptroller of Currency ("OCC") licensing, regulation, supervision, examination, and enforcement authority. They further assert that California's "per diem" statutes, which prohibit mortgage lenders from charging any interest on residential first mortgages for a period in excess of one day prior to recording of the mortgage, are expressly preempted by the Depository Institutions Deregulation and Monetary Control Act of 1980 ("DIDMCA"). See Cal. Civ. Code § 2948.5; Cal. Fin. Code § 50204(o). The OCC participated as *amicus curiae* in this case. The Commissioner opposes the motion arguing that because NCMC possesses a California-issued license for its mortgage lending business in California, it is obligated to comply with all licensing requirements; that NCMC, as an operating subsidiary of National City Bank, is not a national bank that is subject to the exclusive visitorial power of the OCC; and that DIDMCA does not preempt California's per diem statutes. (Def.'s Opp'n to Mot. for Prelim. Inj. ("Def.'s Opp'n") at 1-2.)

The Commissioner also contends that National City Bank lacks standing to bring this action because he has never attempted to enforce any California law against it. (Def.'s Opp'n at 42.) National City Bank counters that the majority of its residential mortgage loans are made through its operating subsidiary NCMC. Therefore the Commissioner's attempt to enforce California's per diem laws against NCMC threatens interference with National City Bank's ability to conduct lending activities through NCMC. This allegation is sufficient to establish National City Bank has standing.

The motion was argued May 5, 2003.

BACKGROUND

National City Bank is a federally chartered national bank organized under the National Bank Act ("the Act"), 12 U.S.C. § 21 *et seq.* (Decl. of Stephen Stitle ¶ 2.) It wholly owns and operates NCMC as an operating subsidiary to conduct the majority of its residential mortgage lending throughout the United States, including California. (Decl. of Leo Knight ¶ 2.) In July 1997, NCMC obtained a license to engage in real estate lending activities in California under the California Residential Mortgage Lending Act ("CRMLA"). At that time, it was a subsidiary of National City Bank's holding company, National City Corporation. (Id. ¶ 6; Decl. of Diaun Burns Ex. 2.) NCMC makes residential real estate loans aggregating more than $1 million per year. (Decl. of Knight ¶ 4.) Its California accounts generate tens of millions of dollars a year in gross revenue. (Id. ¶ 5.)

The Commissioner conducted an August 2002 audit and examination of NCMC which he asserts reveals NCMC violated California's per diem statutes by charging interest for more than one day prior to the recordation of mortgages. (Id. ¶ 8.) On February 27, 2003, the Commissioner demanded that NCMC conduct an audit of its residential mortgage loans made in California from August 2000 to the present to identify all loans where interest was charged in excess of that allowed under California Financial Code § 50204(o) (California's per diem statute) and those consumers entitled to a refund. (Decl. of Yolanda Cherry ¶ 5, Ex. 1.) NCMC refused in a letter dated March 28, 2003, asserting it is National City Bank's wholly owned subsidiary and is only subject to OCC's exclusive regulatory authority. (Id., Ex. 2.)

PRELIMINARY INJUNCTIONS STANDARDS

To obtain a preliminary injunction, each Plaintiff must demonstrate either: "(1) a combination of probable success on the merits and the possibility of irreparable injury if relief is not granted; or (2) the existence of serious questions going to the merits and that the balance of hardships tips sharply in its favor." Int'l Jensen, Inc. v. Metrosound U.S.A., Inc., 4 F.3d 819, 822 (9th Cir. 1993). "Each of these two formulations requires an examination of both the potential merits of the asserted claims and the harm or hardships faced by the parties." Sammartano v. First Judicial Dist. Court, in and for County of Carson City, 303 F.3d 959, 965 (9th Cir. 2002). "The alternative standards are not separate tests but the outer reaches of a single continuum," Int'l Jensen, Inc., 4 F.3d at 822 (quotations and citations omitted), "in which the required degree of irreparable harm increases as the probability of success decreases." Sammartano, 303 F.3d at 965. When the action involves the public interest, "the district court must also examine whether the public interest favors the plaintiff." Id.

DISCUSSION

I. Likelihood of Success

A. Federal Preemption of the Commissioner's Exercise of Visitorial Powers over NCMC

Plaintiffs argue the Commissioner's assertion of regulatory authority over NCMC as a licensee under CRMLA is preempted by federal law. Plaintiffs contend the Act authorizes national banks to conduct banking services through operating subsidiaries and that such operating subsidiaries, like national banks, are subject to the OCC's exclusive regulatory authority. (Pls.' Mem. of P. & A. ("Pls.' Mem.")

at 4.) The OCC agrees with Plaintiffs' position, stating "in its capacity as administrator of the national banking system . . . [and] pursuant to 12 U.S.C. § 484 and federal regulations, [it] has exclusive 'visitorial' power over national banks and their operating subsidiaries except where federal law specifically provides otherwise."[1] (OCC Amicus Br. at 2.) The OCC has promulgated 12 C.F.R. § 7.4006, which concerns its exclusive visitorial powers over national banks and provides: "[u]nless otherwise provided by Federal law or OCC regulation, State laws apply to national bank operating subsidiaries to the same extent that those laws apply to the parent national bank." The OCC contends § 7.4006 preempts the Commissioner's asserted right to exercise visitorial powers over NCMC. The regulation in essence considers an operating subsidiary of a

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[1] "[T]he term 'visitorial' powers as used in section 484 generally refers to the power of the OCC to 'visit' a national bank to examine its activities and its observance of applicable laws, and encompasses any examination of a national bank's records relative to the conduct of its banking business as well as any enforcement action that may be undertaken for violations of law." (OCC Amicus Br. at 2-3.)

> The term "visitorial" power [in section 484] has deep historical roots. "At common law the right of visitation was exercised by the King as to civil corporations, ..." One of the earliest interpretations of the OCC's "visitorial power" within the context of . . . the predecessor [statute] to the current section 484, stated:
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> "Visitation, in law, is the act of a superior or superintending officer, who visits a corporation to examine into its manner of conducting its business, and enforce an observance of its laws and regulations. . . . [T]he word ['visitation' has been defined] to mean 'inspection; superintendence; direction; regulation.'"

First Union Nat'l Bank v. Burke, 48 F. Supp. 2d 132, 144 (D. Conn. 1999) (internal citations omitted).

national bank to be an "instrumentalit[y] of the federal government . . . subject to the paramount authority of the United States." Bank of America v. City and County of San Francisco, 309 F.3d 551, 561 (9th Cir. 2002).

The Commissioner argues nothing in the National Bank Act ("the Act") empowered the OCC to issue § 7.4006. (Def.'s Opp'n at 9, 12.) The OCC counters that Congress implicitly authorized it to promulgate the regulation in the incidental powers section of 12 U.S.C. § 24 (Seventh), the visitorial powers section in 12 U.S.C. § 484, and through acknowledgment in the Gramm-Leach-Bliley Act ("GLBA") that national banks can have operating subsidiaries.

Whether OCC's promulgation of § 7.4006 is within the sphere of authority delegated to it by Congress and whether § 7.4006 has preemptive effect depends on Congressional intent gleaned from the Act. "Preemption may be either express or implied, and 'is compelled whether Congress' command is explicitly stated in the statute's language or implicitly contained in its structure and purpose.'" Fidelity Federal Savings and Loan Ass'n v. de la Cuesta, 458 U.S. 141, 152-53 (1982)(citation omitted).

> [When] explicit pre-emption language does not appear, or does not directly answer the question . . . . courts must consider whether the federal statute's "structure and purpose" or nonspecific statutory language, nonetheless reveal a clear, but implicit, pre-emptive intent. . . . A federal statute, for example, may create a scheme of federal regulation "so pervasive as to make reasonable the inference that Congress left no room for the States to supplement it." . . . Alternatively, federal law may be in "irreconcilable conflict" with state law. . . . Compliance with both statutes, for example, may be a "physical impossibility," . . .; or, the state law may "stan[d] as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress."

Barnett Bank of Marion County, N.A. v. Nelson, 517 U.S. 25, 31 (1996) (citations omitted). "Federal regulations have no less pre-emptive effect than federal statutes." Fidelity Federal Savings and Loan Ass'n, 458 U.S. at 153-54.

1. National Bank Act

National banks are created and governed by the National Bank Act. The Act was enacted to "facilitate . . . 'a national banking system,'" Marquette Nat'l Bank of Minneapolis v. First of Omaha Serv. Corp., 439 U.S. 299, 314-15 (1978)(quoting Cong. Globe, 38th Cong., 1st Sess., 1451 (1864)), and "to protect national banks against intrusive regulation by the States." Bank of America v. City and County of San Francisco, 309 F.3d 551, 561 (9th Cir. 2002). "The National Bank Act (12 U.S.C. § 21 et seq.) constitutes by itself a complete system for the establishment and government of national banks." Deitrick v. Greaney, 309 U.S. 190, 194 (1940)(quotations and citations omitted). The Act provides that national banks shall have power

> [t]o exercise. . .all such incidental powers as shall be necessary to carry on the business of banking; by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; by receiving deposits; by buying and selling exchange, coin, and bullion; by loaning money on personal security; and by obtaining, issuing, and circulating notes. . . .

12 U.S.C. § 24 (Seventh). The OCC is the administrator charged with supervision of the Act and bears "primary responsibility for surveillance of 'the business of banking' authorized by § 24

(Seventh)."[2] NationsBank of North Carolina, N.A. v. Variable Annuity Life Ins. Co., 513 U.S. 251, 256 (1995); see 12 U.S.C. §§ 1, 26-27, 481. The Act prescribes: "No national bank shall be subject to any visitorial powers except as authorized by Federal law, vested in the courts of justice or such as shall be, or have been exercised or directed by Congress. . . ." 12 U.S.C. § 484(a).

While the Commissioner concedes the OCC has exclusive visitorial power over national banks, as he argued through counsel at the May 5 hearing, "what we're talking about here is not a national bank but an operating subsidiary of a national bank." (Reporter's Transcript of May 5, 2003 hearing at 27.) Therefore, he contends that OCC's regulatory authority does not extend to NCMC. He argues the OCC has not been authorized to declare itself the exclusive regulatory authority over NCMC.[3] (Def.'s Opp'n at 9.) Plaintiffs counter that since NCMC is an operating subsidiary, NCMC "act[s] as [a] separately incorporated division[] or department[] of the national bank itself." (Pls.' Mem. at 5.) The OCC agrees with Plaintiffs stating, "When

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[2] The Act authorizes the OCC to "appoint examiners who shall examine every national bank as often as the Comptroller of the Currency shall deem necessary. The examiner making the examination of any national bank shall have power to make a thorough examination of all the affairs of the bank and in doing so he shall have power to administer oaths and to examine any of the officers and agents thereof under oath and shall make a full and detailed report of the condition of said bank to the Comptroller of the Currency. . . ." 12 U.S.C. § 481. "The provisions of the Act requiring periodic examinations and reports and the powers of the Comptroller are designed to insure prompt discovery of violations of the Act and in that event prompt remedial action by the Comptroller." Deitrick, 309 U.S. at 195.

[3] At the May 5 hearing, the Commissioner explained that if an operating subsidiary of a national bank has an independent corporate structure from that of the national bank's, then OCC is not authorized under the Act to exercise the exclusive visitorial powers it has over the national bank, over the operating subsidiary.

established in accordance with the procedures mandated by the OCC Operating Subsidiary Rule and approved by the OCC, the operating subsidiary is a federally-authorized means by which a national bank may conduct federally-authorized activities." (OCC Amicus Br. at 13.)

2. Operating Subsidiaries

The OCC asserts that "[p]ursuant to [national banks'] authority under 12 U.S.C. § 24 (Seventh) to exercise 'all such incidental powers as shall be necessary to carry on the business of banking,' national banks have long used separately incorporated entities to engage in activities that the bank itself is authorized to conduct." (OCC Amicus Br. at 11-12.) "Incidental powers [in § 24 (Seventh)] include activities that are 'convenient or useful in connection with the performance of one of the bank's established activities pursuant to its express powers under the National Bank Act.'" Bank of America, 309 F.3d at 562 (citations omitted). The United States Supreme Court held that the "'business of banking' is not limited to the enumerated powers in § 24 Seventh and that the Comptroller therefore has discretion to authorize activities beyond those specifically enumerated. The exercise of the Comptroller's discretion, however, must be kept within reasonable bounds." NationsBank of North Carolina, N.A., 513 U.S. at 258 n.2.

The OCC has promulgated an operating subsidiary rule in 12 C.F.R. § 5.34, which prescribes: "[a] national bank may conduct in an operating subsidiary activities that are permissible for a national bank to engage in directly either as part of, or incidental to, the business of banking, as determined by the OCC, or otherwise under other statutory authority. . . ." Section 5.34(e)(3) provides: "[a]n operating subsidiary conducts activities authorized under this section

pursuant to the same authorization, terms and conditions that apply to the conduct of such activities by its parent national bank."[4]

At the May 5 hearing, the Commissioner virtually conceded that the OCC's interpretation of 12 U.S.C. § 24 (Seventh) as authorizing national banks to conduct the business of banking through operating subsidiaries was "probably" reasonable in light of NationsBank of North Carolina, N.A., 513 U.S. at 258 n.2. However, the Commissioner insisted that this statute does not authorize the OCC to exercise exclusive visitorial powers over operating subsidiaries. The Commissioner's equivocal position on the issue requires it to be evaluated.

Both parties cite to the GLBA's definition of "financial subsidiary" as support for their respective positions on whether the Act empowers a national bank to conduct banking business through an operating subsidiary. Plaintiffs and the OCC argue Congress acknowledged national banks' authority to conduct banking business in this manner in the GLBA's definition of "financial subsidiary." The Commissioner counters that the "financial subsidiary" statutory section evinces Congress never intended national banks to do banking business through "operating subsidiaries." (Def.'s Opp'n at 20-22.)

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[4] Before a national bank could be authorized to conduct permissible banking activities through an operating subsidiary, the bank must comply with the OCC's licensing requirements. Under 12 C.F.R. § 5.34, "A national bank must file a notice or application as prescribed in this section to acquire or establish an operating subsidiary, or to commence a new activity in an existing operating subsidiary." "The OCC reviews a national bank's application to determine whether the proposed activities are legally permissible and to ensure that the proposal is consistent with safe and sound banking practices and OCC policy and does not endanger the safety or soundness of the parent national bank." Id. § 5.34(e)(5)(iii).

The Commissioner's reliance on this language is misplaced. The statutory definition recognizes that "operating subsidiaries" could exist by stating a "'financial subsidiary' . . . is . . . other than a subsidiary that . . . engages solely in activities that national banks are permitted to engage in directly and are conducted subject to the same terms and conditions that govern the conduct of such activities by national banks." 12 U.S.C. § 24a(g)(3). Not only does this language reference operating subsidiaries, it indicates the OCC exercises visitorial authority over them. A Senate Report explaining the scope and purpose of the GLBA explicitly addresses the use of operating subsidiaries by national banks:

> For at least 30 years, national banks have been authorized to invest in operating subsidiaries that are engaged only in activities that national banks may engage in directly. For example, national banks are authorized directly to make mortgage loans and engage in related mortgage banking activities. Many banks choose to conduct these activities through subsidiary corporations. Nothing in this legislation is intended to affect the authority of national banks to engage in bank permissible activities through subsidiary corporations, or to invest in joint ventures to engage in bank permissible activities with other banks or nonbank companies.

S. Rep. No. 106-44, at 8 (1999).[5]

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[5] The OCC also recognized several years ago, in 1966, that national banks are empowered to conduct authorized banking business through subsidiaries by its announcement in the Federal Register:

> The Comptroller of the Currency has confirmed his position that a national bank may acquire and hold the controlling stock interest in a subsidiary operations corporation. . . . A subsidiary operations corporation is a corporation the functions or activities of which are limited to one or several of the functions or activities that a national bank is authorized to carry on.

(continued...)

Moreover, court decisions determining whether a particular activity is permissible for a national bank have treated the activities of an operating subsidiary as being equivalent to the activities of the national bank. See NationsBank of North Carolina, N.A., 513 U.S. at 254 (brokerage subsidiary acting as an agent in the sale of annuities); Marquette Nat'l Bank of Minneapolis, 439 U.S. 299 (credit card subsidiary); American Ins. Ass'n v. Clarke, 865 F.2d 278 (D.C. Cir. 1988) (subsidiary offering municipal bond insurance); M & M Leasing Corp. v. Seattle First Nat'l Bank, 563 F.2d 1377 (9th Cir. 1977) (motor vehicle leasing by subsidiary).

The OCC's regulation authorizing national banks to conduct banking business through operating subsidiaries appears to be a permissible reading of the Act and likely to be found within its discretionary authority delegated to it by Congress. "The

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[5](...continued)

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> [T]he authority of a national bank to purchase or otherwise acquire and hold stock of a subsidiary operations corporation may properly be found among 'such incidental powers' of the bank 'as shall be necessary to carry on the business of banking,' within the meaning of 12 U.S.C. 24 (7), or as an incident to another Federal banking statute which empowers a national bank to engage in a particular function or activity. . . . The visitorial powers vested in this Office are adequate to ascertain compliance by bank subsidiaries with the limitations and restrictions applicable to them and their parent national banks.

Acquisition of Controlling Stock Interest in Subsidiary Operations Corporation, 31 Fed. Reg. 11,459 at 11,459-60 (Aug. 31, 1966). This interpretative pronouncement reflected OCC's then-held view on existing law. Gibson Wine Co. v. Snyder, 94 F.2d 329, 331 (D.C. Cir. 1952 ("Administrative officials frequently announce their views as to the meaning of statutes or regulations.").

Comptroller's determination as to what activities are authorized under the National Bank Act should be sustained if reasonable." First Nat'l Bank of Eastern Arkansas v. Taylor, 907 F.2d 775, 777-78 (8th Cir. 1990).

For the stated reasons, Plaintiffs are likely to prevail on their argument that NCMC is an operating subsidiary of a national bank which "is subject to the same federal [authority] as its parent [national bank] and is treated as a department or division of its parent for regulatory purposes." WFS Financial, Inc. v. Dean, 79 F. Supp. 2d 1024, 1026 (W.D. Wis. 1999).

3. OCC's Exclusive Visitorial Powers over Operating Subsidiaries

But the Commissioner disagrees with Plaintiffs' assertion that the OCC exercises exclusive visitorial powers over NCMC, arguing that this position constitutes an improper intrusion on the Commissioner's visitorial powers over NCMC. The OCC asserts "[b]ecause federal law prohibits the [Commissioner] from exercising visitorial powers over a national bank engaged in real estate lending pursuant to federal law, the [Commissioner] may not exercise visitorial power over the national bank conducting that activity through an operating subsidiary licensed by the OCC, absent federal law dictating a contrary result."[6] (OCC Amicus Br. at 14.)

Since Plaintiffs appear likely to prevail on their position that NCMC is a federally licensed operating subsidiary of its parent national bank, it follows that NCMC is likely to be found to be a

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[6] Under 12 U.S.C. § 371, national banks "may make, arrange, purchase or sell loans or extensions of credit secured by liens on interests in real estate. . . ."

federal instrumentality of a national bank subject to the paramount visitorial powers of the OCC. Bank of America, 309 F.3d at 561. Therefore, Plaintiffs appear likely to prevail on the merits of this issue.

But NCMC has paradoxically subjected itself to the Commissioner's regulatory visitorial power by virtue of its status as a California licensee; yet NCMC contends the Act authorizes it to renege on its California license requirements, which subject it to the Commissioner's visitorial powers, based on its position that under the Act it is subject only to the OCC's visitorial powers. When banking activities are governed by federal preemption, federal law applies even where an instrumentality of a national bank has needlessly subjected itself to state licensing law. See Wells Fargo Bank, N.A. v. Boutris, 2003 WL 1220131, at *7 (E.D. Cal., Mar. 10, 2003) citing ANR Pipeline Co. v. Iowa State Commerce Com'n, 828 F.2d 465, 466-73 (8th Cir. 1987) (revealing that where the Pipeline Company unnecessarily obtained a state permit and violated the permit requirements, it could continue doing work on the interstate gas pipeline under federal authority, even though the state sought to stop the work because of the violations). Therefore NCMC is likely to prevail on its position that it is subject to OCC's exclusive regulatory authority. See generally Nat'l State Bank, Elizabeth, N.J. v. Long, 630 F.2d 981, 988 (3d Cir. 1980)(revealing that a national bank need not be subject to the visitorial powers of both a federal and state agency).

The Commissioner further argues that "[b]y promulgating regulations seeking to regulate operating subsidiaries of national banks to the exclusion of states, the OCC is interfering with

California's constitutional sovereignty under the Tenth Amendment and taking away the state's power to regulate and enforce its laws against state-chartered corporations such as NCMC." (Def.'s Opp'n at 12.) Since NCMC is likely to prevail on its position that when it became an OCC-authorized operating subsidiary of a national bank, the regulatory authority over it changed from the Commissioner to the OCC, the question the Commissioner raises is whether this change in regulatory authority is likely to be found an infringement on California's rights under the Tenth Amendment.

The Tenth Amendment provides, "The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the People." It has long been recognized that the Constitution authorizes Congress to establish national banks. See M'Culloch v. Maryland, 17 U.S. 316, 424-25 (1819). The National Bank Act's effect of "carv[ing] out from state control supervisory authority" over an OCC-authorized operating subsidiary of a national bank does not violate California's Tenth Amendment rights. First Union Nat'l Bank, 48 F. Supp. 2d at 148.

> Under the national banking regulatory scheme, Congress does not direct the state executive to affirmatively function in any particular way, nor does the OCC's exercise of exclusive visitorial powers over national banks preclude the state statutory enactments from being applied to national banks, provided they are not in conflict with and thus preempted by federal banking laws. By creating such a scheme, Congress has not seized the machinery of state government to achieve federal purposes. The relegation of regulatory and supervisory authority over federal instrumentalities to a single federal regulator does not interfere with the Commissioner's enforcement of state law against state banks, does not interfere with the state's enactment of non-preempted state banking laws applicable to national banks, does not preclude the Commissioner from seeking OCC enforcement of state laws, and

> expressly leaves available judicial remedies to compel national bank compliance with state law.

Id. at 148-49; see Clark v. U.S., 184 F.2d 952, 954 (10th Cir. 1950) ("Congress has the power to enact legislation for the protection, preservation and regulation of [national banks]"(citing Westfall v. United States, 274 U.S. 256 (1927); Farmers' and Mechanics' Nat'l Bank v. Dearing, 91 U.S. 29 (1875); M'Culloch, 17 U.S. 316; Doherty v. United States, 94 F.2d 495, 497 (8th Cir. 1938); Weir v. United States, 92 F.2d 634, 636 (7th Cir. 1937))).

Therefore, the Commissioner is not likely to prevail on his argument that the Act's empowerment of the OCC to exercise exclusive visitorial powers over operating subsidiaries of national banks violates California's constitutional sovereignty under the Tenth Amendment.

For the stated reasons, Plaintiffs have shown probable success on the merits of their claim that NCMC is a wholly-owned operating subsidiary of National City Bank, licensed by the OCC to engage in real estate lending activities in California, and that "the National Bank Act [and federal regulations] preempt[] the Commissioner's authority" to prohibit NCMC from doing business in California and from exercising visitorial powers over Plaintiffs.[7] First Nat'l Bank of Eastern Arkansas, 907 F.2d at 778.

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[7] The Commissioner also argues that the OCC's operating subsidiary regulation is not retroactive but that argument is not reached because, as will be discussed infra, Plaintiffs appear likely to prevail on their position that California's per diem statutes are preempted by federal law, which are the only statutes at issue with respect to the regulatory dispute over which entity is authorized to exercise visitorial powers over NCMC.

B. Depository Institutions Deregulation and Monetary Control Act of 1980

Plaintiffs also contend that California's per diem laws cannot be enforced against NCMC because the DIDMCA expressly preempts them. Under DIDMCA,

> The provisions of the constitution or the laws of any State expressly limiting the rate or amount of interest, discount points, finance charges, or other charges which may be charged, taken, received, or reserved shall not apply to any loan, mortgage, credit sale, or advance which is - -
>
> (A) secured by a first lien on residential real property. . .
>
> (B) made after March 31, 1980; and
>
> (C) [a federally related mortgage loan]

12 U.S.C. § 1735f-7a(a). A "federally related mortgage" "(1) is secured by residential real property designed principally for the occupancy of from one to four families; and (2). . .(D) is made in whole or in part by any 'creditor', as defined in section 1602(f) of Title 15, who makes or invests in residential real estate loans aggregating more than $1,000,000 per year." 12 U.S.C. § 1725f-5(b). A "creditor" is:

> a person who both (1) regularly extends, whether in connection with loans, sales of property or services, or otherwise, consumer credit which is payable by agreement in more than four installments or for which the payment of a finance charge is or may be required, and (2) is the person to whom the debt arising from the consumer credit transaction is initially payable on the face of the evidence of indebtedness or, if there is no such evidence of indebtedness, by agreement.

15 U.S.C. § 1602(f). The declarations of Stephen A. Stitle, the chairman of the board, president, and chief executive office of

National City Bank, and Leo Knight, the chairman and chief executive officer of NCMC, indicate that NCMC qualifies as a creditor within the meaning of the statute and that the residential loan transactions at issue are subject to DIDMCA. States were able to override DIDMCA's express preemption by explicitly opting out of its terms prior to April 1, 1983. Id. § 1735f-7a(b)(2). There is no evidence that California opted out of DIDMCA's express preemption within the statutorily prescribed time period.

California's per diem statutes prohibit interest from being charged on a mortgage for a period in excess of one day prior to recording of the mortgage. Cal. Civ. Code § 2948.5; Cal. Fin. Code § 50204(o). California Civil Code § 2948.5 provides, "[a] borrower shall not be required to pay interest on a principal obligation under a promissory note secured by a mortgage or deed of trust on real property improved with between one to four residential dwelling units for a period in excess of one day prior to recording of the mortgage or deed of trust if the loan proceeds are paid into escrow. . . ." In addition, under the CRMLA, a licensee may not "[r]equire a borrower to pay interest on the mortgage loan for a period in excess of one day prior to recording of the mortgage or deed of trust," except under certain circumstances that are not relevant to the present motion. Cal. Fin. Code § 50204(o).

Plaintiffs argue that California's per diem statutes expressly limit the amount of interest that a lender may collect on federally related mortgage loans and therefore are preempted by DIDMCA. (Pls.' Mem. at 15.) Plaintiffs support their position by relying primarily on Shelton v. Mutual Savings and Loan Ass'n, 738 F. Supp. 1050 (E.D. Mich. 1990). In Shelton, the plaintiffs argued

defendant Bank "violated the Michigan usury statute, M.C.L. sections 438.31c(2) and (9), by charging interest before the loan proceeds were disbursed." Id. at 1053. The court explained, "the broadest possible interpretation of the exemption from state usury laws is consistent with the legislative purpose [of DIDMCA]," and therefore held Michigan's usury law was preempted by DIDMCA. Id. at 1057-58.

The Commissioner argues that the per diem statutes currently at issue are not state usury laws, rather they "merely encourage[] lenders to be assiduous in providing borrowers with recorded title and trust deeds by preventing them from charging interest in excess of an allowable one day time period until the documents are recorded." (Def.'s Opp'n at 34.) Further, the Commissioner contends the purpose behind the per diem restrictions is to protect consumers by "placing responsibility for any delays between funding and recording the deed on the lender." (Id. at 37.)

DIDMCA preempts "[t]he provisions of the constitution or the laws of any State expressly limiting the rate or amount of interest, discount points, finance charges, or other charges which may be charged, taken, received, or reserved. . . " on particular types of loans. 12 U.S.C. § 1735f-7a(a). The plain language of the statute does not appear to limit the preemptive scope of DIDMCA to state usury laws. However, the relevant legislative history of the statute indicates otherwise. The Senate Report that accompanied the bill containing what became 12 U.S.C. § 1735f-7a provides:

> In order to ease the severity of the mortgage credit crunches of recent years and to provide financial institutions, particularly those with large mortgage portfolios, with the ability to offer higher interest rates on savings deposits, H.R. 4986 as reported by the Committee would

> preempt any state constitutional or statutory provision setting a limit on mortgage interest rates. . . .
>
> H.R. 4986 as amended provides for a limited preemption of state usury laws. It provides that the state constitutional or statutory restrictions on the amount of interest, discount points or other charges on any loan, mortgage or advance secured by real estate which is described in section 527(B) of the National Housing Act are exempt from usury ceilings. . . .
>
> The Committee believes that this limited modification in state usury laws will enhance the stability and viability of our nation's financial system and is needed to facilitate a national housing policy and the functioning of a national secondary market in mortgage lending. . . .
>
> In exempting mortgage loans from state usury limitations, the Committee intends to exempt only those limitations that are included in the annual percentage rate. The Committee does not intend to exempt limitations on prepayment charges, attorney fees, late charges or similar limitations designed to protect borrowers.

S. Rep. No. 96-368, at 18-19 (1979), reprinted in 1980 U.S.C.C.A.N. 236, 254-55. The relevant legislative history makes clear that Congress intended to create a limited preemption of state usury laws. See Brown v. Investors Mortgage Co., 121 F.3d 472, 476 (9th Cir. 1997)("Congress made specific findings that modification of state usury laws was necessary for a stable national financial system.").

"Usury law" is defined as "law that prohibits moneylenders from charging illegally high interest rates." Black's Law Dictionary (7th ed. 1999). In California, "usury" has been defined as "taking more than the law allows upon a loan or for forbearance of a debt." Hall v. Beneficial Fin. Co., 118 Cal. App. 3d 652, 654 (1981)(citation omitted). Because California's per diem laws regulate the amount of interest a lender may charge by imposing a time restriction on when a lender may begin to charge interest, they are in essence usury laws.

The Commissioner argues that California's per diem statutes do not fall within the preemptive scope of DIDMCA because they are designed to protect consumers and they do not expressly limit interest rates or amounts. (Def.'s Opp'n at 37.) The Commissioner compares California's per diem statutes with the simple interest statute ("SIS") that was held not preempted by DIDMCA in Grunbeck v. Dime Savings Bank of New York, 74 F.3d 331 (1st Cir. 1996). The SIS requires that any interest rate or amount agreed to by the parties be computed on a "simple interest" basis. Grunbeck, 74 F.3d at 337. The court explained,

> [t]he SIS . . . does not "serve to . . . restrain" either the rate or the amount of simple interest which may be obtained, since the lender remains free to compensate by increasing the simple interest rate. Thus, the SIS does not "expressly" limit "the rate or amount of interest." Nor, in the alternative, does the SIS--as distinguished from market forces-- "limit" the rate or amount of interest if "limit" means a "final, utmost or furthest boundary" on the rate or amount of interest, since the SIS imposes no ceiling whatsoever on either the rate or amount of simple interest that may be exacted.

Id. at 338 n.6. The Commissioner argues that like the SIS, the per diem statutes do not expressly limit the amount of interest a lender may charge. (Def.'s Opp'n at 36.)

Plaintiffs argue that Grunbeck is factually distinguishable. Unlike the SIS, California's per diem restriction does not leave "entirely to the parties the rate and amount of . . . interest to be exacted" because once escrow has closed Plaintiffs have no way of collecting interest lost by delays in recording the deed of trust. Grunbeck, 74 F.3d at 337. Plaintiffs contend NCMC is unable to bargain for a higher interest rate that would compensate for the

possible delay in recordation of the mortgage or deed of trust because, after the loan is funded, when the recordation occurs depends on the action of others: the settlement agents, the escrow company, and the county clerk who records the mortgage. Furthermore, as Plaintiffs correctly contend, "the parties cannot contract around the per diem interest restriction, as . . . could [occur] with the [SIS] in Grunbeck, because (among other reasons) the pre-closing disclosures required by the Truth in Lending Act, 15 U.S.C. § 1601 *et seq.*, and Regulation Z, 12 C.F.R. part 226, make it impossible to change the interest rate set on a loan after closing." (Pls.' Mem. at 17.)

The Commissioner's claim that the per diem statutes are designed to protect consumers from unseen costs is unpersuasive. Once the lender distributes funds to the consumer, the consumer has received the "benefit of the bargain." The act of recordation of the mortgage or deed of trust provides "constructive notice" of the contents of these documents to third parties. See Domarad v. Fisher & Burke, Inc., 270 Cal. App. 2d 543, 554 (1969)("The purpose of the recording statutes is to give notice to prospective purchasers or mortgagees of land of all existing and outstanding estates, titles or interest, whether valid or invalid, that may affect their rights as bona fide purchasers.").

Yet DIDMCA preempts only those state laws "expressly limiting the rate or amount of interest . . ." charged on particular residential mortgage loans. 12 U.S.C. § 1735f-7a(a). "When engaged in the task of statutory interpretation, 'courts . . . should . . . attempt to give meaning to each word and phrase.'" Grunbeck, 74 F.3d at 338 (citation omitted). Thus, the question is whether the per diem statutes expressly place a ceiling on interest rates or amounts.

California's per diem statutes establish when interest can be charged by prohibiting a lender from charging interest on a mortgage for a period in excess of one day prior to recordation of the mortgage. Cal. Civ. Code § 2948.5; Cal. Fin. Code § 50204(o). By restricting the time period in which a lender may collect interest on loaned funds, the language of the per diem statutes "expressly limit[s] the rate or amount of interest. . . which may be charged . . . ." Therefore, Plaintiffs are likely to prevail on their position that DIDMCA preempts California's per diem statutes.

II. Hardships Faced by the Parties

Plaintiffs contend they will suffer irreparable harm if the Commissioner is allowed to exercise visitorial powers over them. NCMC claims if forced to comply with the Commissioner's demand for an audit, it would have to undertake a manual audit of more than 150,000 mortgage loan files, which it estimates would cost in excess of $4 million. (Pls.' Mem. at 17-18; Decl. of Knight ¶¶ 9, 10.) Plaintiffs contend such costs cannot be recovered. (Pls.' Mem. at 18.)

The Commissioner argues Plaintiffs' alleged audit costs are unsupported and based on inflated loan numbers, and Plaintiffs will not lose significant revenue by making any per diem interest corrections required by CRMLA. The Special Administrator for the CRMLA estimates the total amount of loans NCMC made or brokered in California for August 2000 through December 2002 equals 97,848. (Decl. of Burns ¶ 9.) Assuming this more accurately reflects the amount of loans NCMC made or brokered, NCMC would still be required to audit almost 100,000 loans, the cost of which could not be recovered.

III. Public Interest

The public interest favors Plaintiffs' position because they have a probability of succeeding on their position that since National City Bank is a national bank and NCMC is an operating subsidiary of a national bank they are subject to the exclusive visitorial powers of the OCC. Furthermore, Plaintiffs have shown a likelihood of prevailing on their claim that California's per diem statutes are preempted by federal law. Plaintiffs have also shown the possibility of irreparable injury if relief is not granted. Moreover, a serious federal and state regulatory dispute is involved and the balance of hardships tips sharply in Plaintiffs' favor on the issue that the Act prohibits the Commissioner from exercising visitorial powers over Plaintiffs.

Therefore, the Commissioner and his agents are preliminarily enjoined from exercising visitorial powers over Plaintiffs and enforcing California's per diem statutes against Plaintiffs.

IT IS SO ORDERED.

DATED: May 7, 2003

GARLAND E. BURRELL, JR.
United States District Judge

mdp

United States District Court
for the
Eastern District of California
May 7, 2003

* * CERTIFICATE OF SERVICE * *

2:03-cv-00655

Natl City Bank of IN

v.

Boutris

I, the undersigned, hereby certify that I am an employee in the Office of the Clerk, U.S. District Court, Eastern District of California.

That on May 7, 2003, I SERVED a true and correct copy(ies) of the attached, by placing said copy(ies) in a postage paid envelope addressed to the person(s) hereinafter listed, by depositing said envelope in the U.S. Mail, by placing said copy(ies) into an inter-office delivery receptacle located in the Clerk's office, or, pursuant to prior authorization by counsel, via facsimile.

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